

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>ANWAR AND ANNETTE RIAD</b>	:	DETERMINATION DTA NO. 818558
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 1996 and 1997.	:	

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Petitioners, Anwar and Annette Riad, 23 Phaeton Drive, Melville, New York 11747, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 1996 and 1997.

A hearing was commenced before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on January 10, 2002 at 10:30 A.M. and was concluded before the same administrative law judge at the same location on March 21, 2002, with all briefs to be submitted by September 30, 2002, which date began the six-month period for the issuance of this determination. Petitioners appeared by Drohan & Drohan, LLP (John P. Drohan III and Vivian R. Drohan, Esqs., of counsel). The Division of Taxation appeared by Barbara G. Billet, Esq. (Barbara J. Russo, Esq., of counsel).

***ISSUES***

- I. Whether petitioners have substantiated their claimed deductions for 1996 and 1997.
- II. Whether petitioners have established reasonable cause to abate penalties imposed upon the deficiencies of income tax asserted by the Division of Taxation.

***FINDINGS OF FACT*<sup>1</sup>**

1. Petitioner Anwar Riad is a Certified Public Accountant and sole practitioner who owned and operated a public accounting practice in Melville, New York during the years at issue. Prior to establishing his own practice, Mr. Riad was a partner in a national CPA firm with international affiliations in all major cities around the world. He left the firm and opened his own practice in approximately 1990.

2. Petitioners filed joint New York State resident income tax returns for 1996 and 1997 and reported the income and claimed expenses from the operation of the accounting practice as Schedule C (Profit or Loss from Business) expenses on both their State and Federal tax returns.

3. In December 1998, the Division of Taxation (“Division”) commenced an audit of petitioners for the years 1996 and 1997 to verify itemized deductions and business expenses claimed on Federal schedules A and C of their personal income tax returns.

4. Upon commencement of the audit, the Division requested that petitioners provide: State and Federal income tax returns and schedules; itemized deduction worksheet and substantiation documentation; documentation to support their Schedule C deductions including books, records, schedules; and other documents pertinent to their tax returns including a general ledger, disbursements journal, payroll ledger, sales/receipts journal, invoices and receipts to support expenses, bank records and canceled checks.

5. The Division’s auditor held meetings with petitioners during the audit and reviewed the documentation which petitioners provided.

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<sup>1</sup> Along with its brief, the Division of Taxation submitted 12 proposed findings of fact (while the proposed findings of fact are numbered “1” through “13”, proposed finding of fact “2” was omitted). In their reply brief, petitioners agreed with these proposed findings of fact; accordingly, each has been incorporated herein. In addition, petitioners submitted one proposed finding of fact, with four additional subparagraphs set forth within. This proposed finding of fact, including the four subparagraphs, is rejected since it is not supported by the record herein.

6. On March 28, 2000 and March 29, 2000, respectively, petitioners and the Division executed a consent extending the period of limitation for assessment of personal income taxes whereby it was agreed that such taxes for the period January 1, 1996 through December 31, 1997 could be determined or assessed at any time on or before April 15, 2001.

7. After reviewing the documentation provided by petitioners, the auditor determined that petitioners failed to substantiate expenses claimed on Schedule C of their return.

8. For the year 1996, petitioner Anwar Riad claimed the following Schedule C expenses related to his public accounting practice:

Advertising - \$660.00	Federal Express & postage - \$1,911.00
Car & truck expenses - \$2,535.00	Mandatory continuing educ. - \$1,490.00
Depreciation - \$3,755.00	Professional dues - \$1,305.00
Insurance - \$4,505.00	Books, periodicals, publications - \$1,847.00
Business indebtedness - \$12,544.00	Christmas expenses & gratuities - \$706.00
Office expense - \$4,613.00	Office cleaning - \$1,965.00
Repairs & maintenance - \$3,727.00	Office phones & fax - \$6,239.00
Supplies - \$3,853.00	Client expenses \$905.00
Taxes & licenses - \$521.00	Business gifts - \$740.00
Meals & entertainment - \$1,405.00	Bank charges - \$45.00
Utilities - \$1,791.00	Painting - \$700.00
Labor - \$1,580.00	Maintenance contracts - \$623.00
Travel to clients - \$9,612.00	Other misc. expenses - \$1,604.00

For 1996, petitioner Anwar Riad filed an additional Schedule C relating to “International Trade” on which he claimed the following expenses:

Advertising - \$478.00	Travel - \$966.00
Car & truck expenses - \$514.00	Meals & entertainment - \$528.00
Legal & prof. services - \$1,050.00	Postage - \$423.00
Office expense - \$846.00	Telephone - \$685.00
Supplies - \$743.00	

9. For the year 1997, petitioner Anwar Riad claimed the following Schedule C expenses relating to his public accounting practice:<sup>2</sup>

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<sup>2</sup> For 1997, petitioner did not file an additional Schedule C for “International Trade.”

Advertising - \$2,591.00	Mandatory continuing educ. - \$1,693.00
Car & truck expenses - \$5,342.00	Professional dues - \$1,180.00
Depreciation - \$2,540.00	Books, periodicals, publications - \$1,415.00
Insurance - \$4,239.00	Christmas expense & gratuities - \$680.00
Interest - \$10,779.00	Office cleaning - \$1,975.00
Office expense - \$6,241.00	Office phones & fax - \$4,648.00
Repairs & maintenance - \$4,470.00	Business gifts - \$695.00
Supplies - \$4,079.00	Bank charges - \$45.00
Taxes & licenses - \$495.00	Maintenance contracts - \$1,338.00
Meals & entertainment - \$2,860.00	Tax forms, library, research - \$495.00
Cost of labor - \$1,650.00	Printing - \$234.00
Public transportation - \$8,714.00	Client expense - \$581.00
Federal Express & postage - \$2,463.00	Other misc. expenses - \$1,706.00

For 1997, petitioner Anwar Raid also filed a form 8829 (Expenses for Business Use of Your Home) on which he claimed that the home was 4,200 square feet and that 1,400 square feet, or 33.33% was used regularly and exclusively for business. On the form 8829, petitioner claimed allowable expenses of \$3,602.00 which represented 33.33% of his insurance expenses (\$2,044.00), utilities (\$5,078.00) and other expenses (\$3,685.00).

10. In arriving at the one-third business use percentage, petitioners included, as portions of the home used for business purposes, the kitchen, living room, basement and garage. While claiming that a portion of the kitchen was used for business, petitioners admitted that it was also used for preparing meals. They further claimed that Mrs. Riad used the living room while she worked on paying office bills and other expenses due to the fact that she needed to keep her feet elevated as a result of a medical condition. Petitioners conceded that the living room was also used for personal purposes (such as watching television) by petitioners and their daughters. The garage, in addition to its use for storage of files, was also utilized by petitioners to store their vehicles and garden tools. The basement was one large area not divided by walls and was used to store petitioner Anwar Riad's files as well as to store various personal items such as Christmas decorations.

***SCHEDULE C EXPENSES CLAIMED FOR 1996***

11. Petitioners claimed advertising expenses of \$660.00 for 1996. The Division, during the audit, allowed \$580.00. Petitioners presented an invoice from Universal Prints, Inc. in the amount of \$233.20 and a letter confirming an ad taken with the First Presbyterian Church in Jamaica for \$350.00. While these were allowed by the Division, it is apparent that the actual sum to be allowed should have been \$583.20 rather than \$580.00. The balance, \$80.00, was unsubstantiated and was, therefore, disallowed by the Division.

12. Petitioners claimed car and truck expenses in the amount of \$2,535.00, attributing 80% of total expenses to business. The Division disallowed the entire amount claimed for failure to substantiate the expenses claimed. Petitioners kept no records of the mileage of their two vehicles which they attribute to the business. Petitioner Anwar Riad has not driven in over 30 years due to poor eyesight and uses the train for most of his business travels; Mrs. Riad does not drive him to the train station when he travels. While claiming that 80% of the vehicles' use was attributable to business, petitioners admitted that the vehicles were also used for personal matters such as mailing personal letters, grocery shopping, doctors' appointments and personal banking. Petitioners' daughter Debra also drove the vehicles in 1996 and 1997 and was involved in an automobile accident in 1997 while driving one of petitioners' vehicles.

13. Petitioners claimed depreciation on a Xerox copier, an office phone, a small copier, a rug, a filing cabinet and two vehicles (an Oldsmobile and a Nissan) for a total of \$3,755.00. The Division allowed \$820.00 for the Xerox machine and assorted supplies for the machine. The depreciation for the rug was disallowed because the invoice stated that it was for the family room. The depreciation on the vehicles was disallowed because petitioners did not prove the business use of the vehicles.

14. Petitioners claimed insurance expenses of \$4,505.00; the Division allowed expenses of \$1,571.00 for professional liability insurance. The amounts claimed for automobile insurance (\$2,220.00) were disallowed by the Division due to petitioners' failure to establish the business use of the vehicles. A check in the sum of \$225.00 paid to AICPA Plus Plan was for additional liability insurance for both the home and the vehicles. Petitioners claimed 80% of this amount which was also disallowed by the Division.

15. Petitioners claimed a business indebtedness or interest expense of \$12,544.00 attributable to interest from debt on credit cards and credit lines and interest from a loan from Sheldon Jacobowitz. The Division disallowed all of this claimed expense because petitioners failed to substantiate a business purpose for these expenses.

The credit cards and credit lines were in petitioners' names; there were none in the name of the business. The Division disallowed the interest expenses on these credit cards and credit lines because petitioners failed to provide a listing of purchases in order that the business purpose could be established. Petitioners claimed that sums of money were borrowed when clients failed to pay, i.e., to cure a cash flow problem. Some of the credit cards were used to transfer balances to obtain a better interest rate. Petitioner Annette Riad admitted that some of the credit cards were used to pay for some personal expenses. She also conceded that some of the original balances were incurred prior to 1996.

Petitioner Anwar Riad contends that he borrowed the sum of \$55,000.00 from Sheldon Jacobowitz and that during 1996, he paid 12 payments of \$458.33 for a total of \$5,499.96. Mr. Riad also submitted a copy of a promissory note dated September 26, 1990 and signed by Mr. Riad and Mr. Jacobowitz. The signatures were not notarized. The promissory note states that the loan was for \$40,000.00, with interest at the rate of 10% per annum with payment due on

September 30, 1992. The promissory note does not state the purpose of the loan; Anwar Riad stated that the loan was due to the fact that his house cost more than the others in the subdivision due to the existence of the home office. While an office did, in fact, exist in the home, there was no addition to the home. The office merely occupied a portion of the home. The home was purchased in February 1989, but the loan from Sheldon Jacobowitz was not made until September 1990.

16. Petitioners claimed \$4,613.00 for office expenses. The majority of these expenses were for grocery items such as milk, Pepsi and snacks and for bathroom supplies, Christmas decorations and assorted other items purchased primarily from grocery stores and pharmacies. These items were allegedly used both by petitioner Anwar Riad and by clients and others who refer clients. The Division disallowed the entire amount claimed for failure to establish a business purpose.

17. Petitioners claimed \$3,727.00 for repairs and maintenance; the Division allowed expenses in the amount of \$790.00 related to replacement of door knobs and locks, some hardware, electrical fixture repair and office door repair. In addition, petitioners provided invoices for repairs to their home (Tri-State Window Factory Corp.) in the sum of \$3,000.00, for air conditioner service (Accu-Air) in the amount of \$153.00, for repair of the front window (A. D'Angelo Glass & Mirror, Inc.) in the amount of \$490.00, for electrical service (M.T.M. Electric, Inc.) in the amount of \$210.00, a plumbing job for the office bathroom in the amount of \$199.80. Other invoices and canceled checks were also presented by petitioners but the purposes therefor could not be ascertained.

18. Petitioners claimed an expense for stationery and office supplies of \$3,853.00; the Division allowed \$996.00 of the expenses claimed. The receipts presented by petitioners were

in a bag and were, therefore, deemed by the auditor to not be in an auditable form. After the first day of hearing, petitioners presented additional receipts which resulted in an additional allowance of \$743.48, for a total allowance of \$1,739.48. Amounts were allowed for receipted expenses which indicated the date and place of purchase along with the business purpose thereof.

19. Petitioners claimed \$521.00 for taxes and licenses. Initially, the Division disallowed these expenses for lack of substantiation. After the first day of hearing, petitioners presented receipts for \$305.00 (New York State Society of CPAs) and for \$116.00 as an administrative fee payable to the AICPA Peer Review Administrators. These receipts totaling \$421.00 were, therefore, allowed by the Division's auditor.

20. Petitioners claimed an expense of \$1,405.00 (representing 50% of expenses of \$2,810.00) for meals and entertainment. Petitioners presented a written summary of these alleged expenses but offered no receipts or other substantiation. The Division disallowed the entire amount claimed.

21. Petitioners claimed expenses for utility costs in the amount of \$1,791.00 which represented one-third of the utility costs. Petitioners claimed one-third of these expenses based upon their contention that one-third of the square footage of the home was used for business. Since they presented no receipts or invoices during the audit to substantiate this amount, the auditor initially disallowed the entire amount. At the first day of hearing, petitioners presented copies of utility bills which were subsequently reviewed by the auditor. Utility expenses of \$528.47, or 10% percent of the heating and electric invoices presented (payments to LILCO for electricity totaled \$3,603.54; payments to S&M Home Heating Corp. totaled \$1,681.20) were allowed based upon the Division's determination that the business percentage of the home office was 10%.



22. Petitioners claimed labor expenses of \$1,580.00. Petitioners produced two checks, each in the amount of \$250.00, one payable to Sherry Riad and one payable to Debbie Riad (these are petitioners' daughters). These expenses totaling \$500.00 were allowed by the Division. The only other document presented was a \$350.00 check payable to cash which was disallowed. No supporting documentation was produced for the balance of the claimed expenses.

23. Petitioners claimed expenses of \$9,612.00 for travel to clients, but offered only written comments to substantiate the expenses claimed; no receipts were presented. Accordingly, the Division disallowed the entire amount claimed therefor.

24. Petitioners claimed Federal Express and postage expenses in the sum of \$1,911.00. During the audit and at the first day of hearing, petitioners presented a handwritten listing of claimed expenses and a bag full of receipts as well as an envelope containing empty stamp books and registered mail receipts which were not in auditable form. As a result, the Division disallowed the entire amount claimed. On the second day of hearing, petitioners presented a number of checks and postage receipts which were reviewed by the auditor. The sum of \$570.21 was subsequently allowed. Petitioner Annette Riad confirmed that she made numerous purchases of postage stamps at Edwards, a grocery market.

25. Petitioners claimed \$1,490.00 for continuing education. In support of these expenses they submitted a CPA registration form in the amount of \$245.00, which was allowed by the Division, and a hotel receipt for \$197.09 for a date in August 1996. The hotel receipt was disallowed because petitioners failed to demonstrate that the hotel stay was for continuing education purposes. The Division disallowed the balance of the claimed expenses for continuing education due to lack of substantiation.

26. Petitioners claimed \$1,305.00 as expenses for professional dues. The Division allowed \$565.00 (\$130.00 for Institute of Management for Accountants; \$165.00 for American Management Association; and \$270.00 for AICPA). No other substantiation was provided.

27. As expenses for books, periodicals and publications, petitioners claimed \$1,847.00. Upon audit, the Division allowed \$739.00 (invoices from Practitioners Publishing Company). Checks paid for the newspaper, Newsday, were disallowed as the business purpose was not established. During the hearing, additional receipts were provided by petitioners; the auditor reviewed these receipts and allowed an additional \$378.72 based thereon. The total allowed by the Division was, therefore, revised to \$1,117.72.

28. Petitioners claimed expenses for Christmas gifts and gratuities in the amount of \$706.00. The Division disallowed all of these claimed expenses. While some department store cash register tapes and receipts were provided, the business purpose of these claimed expenses was not established.

29. Petitioners claimed office cleaning expenses of \$1,965.00. At audit, no substantiation of these claimed expenses was provided and, accordingly, the Division disallowed the entire amount. On the continued hearing date, petitioners provided two receipts for extermination from Excel Pest Control, one for \$480.00 and the other for \$145.00. The receipt for \$145.00 indicated that it was for the office and was, therefore, allowed by the auditor. Since the \$480.00 receipt did not specifically indicate that it was for the office, it was disallowed.

30. Petitioners claimed the sum of \$6,239.00 as expenses for the office phones and fax. The Division allowed expenses totaling \$5,939.00. Expenses for two telephones, a fax number and a mobile telephone were allowed. While petitioners claimed additional expenses attributable to pay phone charges, such expenses were unsubstantiated and, therefore, disallowed by the

Division. Petitioner Anwar Riad admitted that he had no receipts for claimed pay phone charges.

31. Petitioners claimed \$905.00 as client expenses. These were listed on a handwritten summary as out-of-pocket expenses primarily incurred during research and client meetings. There was no substantiation for these claimed expenses and, as a result, the Division disallowed them in their entirety.

32. Petitioners claimed \$740.00 as expenses for business gifts. The only substantiation provided was a handwritten list describing the alleged expenses. No receipts or other documentation was supplied. The Division disallowed the entire amount of these claimed expenses.

33. Petitioners claimed \$45.00 for bank charges. While initially disallowed at audit, these charges were subsequently allowed after documentation was provided by petitioners at the hearing.

34. Petitioners claimed \$700.00 as expenses for painting. The Division disallowed the entire amount because petitioners did not provide documentation to support these claimed expenses. Petitioners claimed that they no longer had the receipt for these expenses.

35. Petitioners claimed expenses in the amount of \$623.00 for maintenance contracts. During the audit, no supporting documentation was provided by petitioners and these expenses were disallowed in their entirety. Between the two dates of hearing, petitioners presented receipts for landscaping charges from Pallazzo Landscaping totaling \$3,945.00. The Division disallowed these expenses claiming that they were not allowable pursuant to IRS Publication 587.

36. Petitioners claimed miscellaneous expenses totaling \$1,604.00 for 1996. The Division disallowed the entire amount due to the failure of petitioners to provide any documentation to substantiate these claimed expenses. Petitioners provided a handwritten list of the alleged expenses which include travel and entertainment with no receipts provided.

37. As to the expenses claimed on the additional Schedule C for International Trade, the auditor disallowed all of the claimed expenses. The only substantiation provided by petitioners was a letter from petitioner Anwar Riad's brother which set forth amounts allegedly incurred for consulting services. No receipts or other supporting documentation were provided.

38. The Division sent an investigator to petitioners' home on August 16, 1999 for the purpose of verifying the existence of the home office. When she arrived at the premises, she initially saw no separate entrance for the office and observed no sign such as "Anwar Riad, CPA." She later discovered a separate entrance at the rear of the home. The office which the investigator estimated to be approximately 600 to 700 square feet was located on the first floor. In this area were a desk, bookshelves and a couch. A bathroom was located in close proximity. Neither the office nor the bathroom appeared to have been freshly painted. In addition to this area on the first floor, a portion of the basement was used for storage of Mr. Riad's files. The basement was totally open, i.e., there were no walls or furnishings.

Subsequent to her visit to petitioners' home, the investigator obtained information concerning the dimensions of the home from the Huntington Town Building Department. This documentation revealed that the first floor of the home consisted of 2,790 square feet, the second floor 1,727 square feet, the basement 2,123 square feet and the garage 483 square feet, for a total of 7,123 square feet.

39. Internal Revenue Service (“IRS”) Publication 587, which sets forth the applicable guidelines for the business use of the home, provides, in relevant part, as follows:

‘Exclusive use’ means only for business. If you use part of your home as your business office and also use that part for personal purposes, you do not meet the exclusive-use test. The business part of your home can be a room or other separately identifiable space; it is not necessary that the part be marked off by a permanent partition. (IRS Publication 587, p. 2.)

Unrelated expenses benefit only the parts of your home that you do not use for business. These include repairs to personal areas of your home, lawn care, and landscaping. You cannot deduct unrelated expenses. (IRS Publication 587, p. 3.)

Indirect expenses are for keeping up and running your entire home. They benefit both the business and personal parts of your home. Examples of indirect expenses include:

- Real estate taxes,
- Deductible mortgage interest,
- Casualty losses,
- Rent,
- Utilities and services,
- Insurance,
- Repairs,
- Security systems, and
- Depreciation. (IRS Publication 587, p. 4.)

To figure deductions for the business use of your home, find the business percentage. You can do this by dividing the area used for business by the total area of your home. You may measure the area in square feet. To figure the percentage of your home used for business, divide the number of square feet of space used for business by the total number of square feet of space in your home. (IRS Publication 587, p. 4.)

40. For the year 1997, the auditor took the percentage of total expenses allowed to gross receipts reported for the 1996 tax year, i.e., 8.91 %, and applied this percentage to the gross receipts reported on petitioners' 1997 Schedule C (\$130,043.00). Accordingly, the Schedule C expenses allowed were \$11,587.00; disallowed expenses or additional income per audit was determined to be \$43,136.00.

41. On June 23, 2000, the Division issued a Notice of Deficiency which asserted a deficiency of \$5,807.89, plus penalty and interest, for a total due of \$8,377.66 for 1996 and a deficiency of \$5,034.35, plus penalty and interest, for a total due of \$6,533.07 for 1997.

42. Petitioners requested a conciliation conference from the Division's Bureau of Conciliation and Mediation Services ("BCMS") which was held on November 15, 2000. Pursuant to a Conciliation Order (CMS No. 181617) issued March 16, 2001, tax due for 1996 and 1997 was recomputed from \$10,842.24 to \$7,155.10, plus penalty imposed pursuant to Tax Law § 685(b) and interest computed at the applicable rate. The reduction in tax was based solely upon the resolution of a separate issue relating to unreported income. During the proceedings before BCMS, petitioners provided additional information concerning the unreported income which resolved this issue.

43. On March 8, 2001, the Division issued a Statement of Personal Income Tax Audit Changes which reflected the recomputations made during the BCMS proceedings. For 1996, the Division asserted additional tax due in the amount of \$3,777.58, plus penalty and interest and for 1997, it asserted additional tax due in the amount of \$3,377.52, plus penalty and interest.

44. During the hearing which commenced on January 10, 2002, petitioners presented additional receipts and documentation which had not previously been provided to the auditor during the audit. At the conclusion of the first day of the hearing, the matter was continued to

March 21, 2002 and petitioners were provided with additional time by the administrative law judge, prior to the continued date of the hearing, to submit receipts and substantiation documentation to the Division in an auditable form.

The Division's auditor reviewed the additional documentation provided by petitioners at the first day of hearing and between the two days of hearing and recomputed the amount of tax due based upon the additional documents provided. Based upon the additional documentation which petitioners provided, the auditor allowed additional Schedule C expenses<sup>3</sup> in the following categories:

Federal Express & postage - allowed \$570.21 based upon 1996 checks to Federal Express, US Postal Service receipts, credit card statements listing charges to US Postal Service and Edwards supermarket receipts for stamps purchased.

Office Cleaning - allowed \$145.00 based upon two exterminator receipts.

Bank charges - allowed \$45.00 based upon checking account statements for three months of 1996.

Utilities - allowed \$528.47 or 10% of two heating bills (\$1,681.20 and \$3,603.54). Water bills were also submitted but were disallowed as household related, not business related expenses.

Books, periodicals, publications - allowed an additional \$378.72 (had previously allowed \$739.00) based upon bills for periodicals; total allowed \$1,117.72.

Taxes & licenses - allowed \$421.00 based upon license invoices.

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<sup>3</sup> These additional allowances have been reflected in the specific Schedule C expenses claimed by petitioners (*see*, Findings of Fact "11" through "36").

Supplies - allowed an additional \$743.48 (had previously allowed \$996.00) based upon stationery receipts; total allowed \$1,739.48.

Based upon this review by the auditor of the documentation presented by petitioners between the two hearing dates, an additional \$2,831.88 in Schedule C expenses was allowed for 1996. In addition, a proportionate amount was allowed for 1997.

A revised Statement of Personal Income Tax Audit Changes, dated March 14, 2002, was issued by the Division to reflect these additional allowances. Pursuant thereto, tax due for 1996 was recomputed from \$3,777.58 to \$3,546.23, plus penalty and interest and tax due for 1997 was recomputed from \$3,377.52 to \$3,151.45, plus penalty and interest.

45. Petitioners did not submit a brief following the hearing. The Division submitted its brief on July 18, 2002 and petitioners submitted a reply brief on September 28, 2002.

#### ***SUMMARY OF THE PARTIES' POSITIONS***

46. Petitioners claimed that one-third of the total square footage of their home was used for business. They contend that the areas indicated on the floor plan of their home as "game room," "guest room" and "Bath 3" are used exclusively for business. Pursuant to plans which petitioners obtained from the Melville Town Building Department which were submitted after the close of the hearing on April 17, 2002, the square footage of the main room ("game room"), second room ("guest room"), office bathroom("Bath 3") and office closet totaled 471.34 square feet. The total square footage of the living space of the house, i.e., the first and second floors of the house (the basement and garage were excluded), is 4,517 square feet.

In addition to the areas designated on the floor plan as "game room," "guest room" and "Bath 3," petitioners claim that they also use a portion of the kitchen, living room, basement and garage for business. They maintain that petitioner Annette Riad uses the kitchen table



(petitioners state that they do not eat at the table) to take care of office bills and handle expenses and the kitchen cabinets as well as the basement for storage of business items such as files, books and publications. Because she needs to elevate her legs due to a medical condition, Mrs. Riad states that she also used the living room to perform business related functions.

Accordingly, petitioners contend that expenses for repairs and maintenance, utilities and maintenance contracts for which petitioners claimed one-third of the total expenses (based upon their allocation of one-third of the home for business purposes) should be allowed.

47. Petitioners also assert that 80% of the vehicle usage was for business purposes, i.e., driving to the post office, dropping Mr. Riad off at meetings and at client locations, etc.

48. The Division maintains that the total square footage of the area indicated on the floor plan as “office” is 467.1 square feet. Since the total square footage of the first and second floor is 4,517 square feet, the percentage used for business purposes is  $467.1 \div 4517 = 10\%$ . While petitioners also claim that they use a portion of the kitchen, living room, basement and garage for business purposes, the Division states that each of these areas is used for personal use as well. As to the basement, while petitioners use a portion for storage of files, it is not divided into business and personal areas and since the basement is also used for storage of personal items, it, like the kitchen, living room and garage, fails the “exclusive use” test as set forth in IRS Publication 587.

### ***CONCLUSIONS OF LAW***

A. A properly issued Notice of Deficiency is presumed to be correct and the taxpayer has the burden of demonstrating the incorrectness of such an assessment ( *Matter of Leogrande v. Tax Appeals Tribunal*, 187 AD2d 768, 589 NYS2d 383, *lv denied* 81 NY2d 704, 595 NYS2d 398; *Matter of Kourakos v. Tully*, 92 AD2d 1051, 461 NYS2d 540, *appeal dismissed* 59 NY2d

967, 466 NYS2d 1030, *lv denied* 60 NY2d 556, 468 NYS2d 467, *cert denied* 464 US 1070, 79 L Ed 2d 215; *Matter of Tavalacci v. State Tax Commn.*, 77 AD2d 759, 431 NYS2d 174). Tax Law § 689(e) provides that in any matter brought before the Division of Tax Appeals under Article 22 of the Tax Law, the burden of proof is upon the petitioner. Accordingly, it is necessary to ascertain whether petitioners have sustained their burden of proof in showing that they are entitled to additional Schedule C expense deductions over and above those already allowed by the Division.

B. Since some of the expenses claimed by petitioners are premised upon the percentage of business use of the home, that percentage must be addressed first. As noted in IRS Publication 587, the business percentage is determined by dividing the number of square feet of space used for business by the total number of square feet of space in the home (*see*, Finding of Fact “39”). As acknowledged by the Division in its brief, when determining the total square footage of a home, it is appropriate to use the area of living space. In this case, the area of living space (the first and second floors) totals 4,517 square feet. Including the basement and garage in this calculation would be a detriment to petitioners since the denominator of this fraction would then be 7,123 square feet.

While petitioners maintain that they used portions of the living room, kitchen, basement and garage for business purposes, it is clear that they were also used for personal purposes by petitioners and their daughters. Accordingly, pursuant to the “exclusive use” test as set forth in IRS Publication 587, it cannot be found that the living room, kitchen, basement and garage were used for business. Since the square footage of the rooms used exclusively for business totaled 471.34 square feet and the total square footage of the living space of the home, excluding the basement and garage, totaled 4,517 (*see*, Finding of Fact “48”), the percentage of business use of

the home is hereby determined to be  $471.34 \div 4517$ , or 10%. Accordingly, while the actual square footage of the portion used for office space as determined by the Division is slightly different (*see*, Finding of Fact “48”), the percentage is the same. Therefore, the 10% business use percentage applied by the Division to claimed expenses for utilities (*see*, Finding of Fact “21”), repairs and maintenance (*see*, Finding of Fact “17”) and maintenance contracts (*see*, Finding of Fact “35”) is found to be correct.

Each claimed expense for 1996 shall hereinafter be considered separately.<sup>4</sup>

C. ADVERTISING - Petitioners did not prove entitlement to more than \$580.00 allowed out of \$660.00 claimed.

D. CAR AND TRUCK EXPENSES - Tax Law § 612(a) provides that New York State adjusted gross income is equal to Federal adjusted gross income. Pursuant to IRC §§ 62(a)(1) and 162(a), in arriving at Federal adjusted gross income, a taxpayer is allowed to deduct “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business (IRC § 162[a]). Automobile expenses incurred in carrying on a business are deductible business expenses under IRC § 162(a) (*Keating v. Commissioner*, 69 TCM 2052). However, no deductions for passenger automobiles are allowed unless the substantiation requirements of IRC § 274[d] are met. No deduction of expenses for an automobile used in carrying on a business is allowed unless the taxpayer:

substantiates by adequate records or by sufficient evidence corroborating the taxpayer’s own statement (A) the amount of such expense or other item, (B) the time and place of the travel . . . , (C) the business purpose of

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<sup>4</sup> Since the deficiency for 1997 was based upon the percentage of expenses allowed by the Division for 1996, only the claimed 1996 Schedule C expenses shall be considered herein. Any increase in the percentage allowed for 1996 will, therefore, increase the percentage of expenses allowed for 1997 and will reduce the 1997 deficiency accordingly.

the expense or other item, and (D) the business relationship to the taxpayer of persons . . . using the facility or property (IRC § 274[d]).

No deductions are allowed for automobile expenses unless a taxpayer substantiates each element of each expense in the manner provided by the regulations (Treas Reg § 1.274-5T[a]). The elements required to be substantiated in the case of automobile expenditures are: the amount of each expenditure, including the amount of usage (i.e., the number of miles the automobile was used for business purposes together with the total mileage the automobile was used during the period in question); the date of the expenditures; and the business purpose of the expenditure (Treas Reg § 1.274-5T[b][6]).

While petitioners have presented receipts for repairs and gasoline purchases, they have not produced any evidence to substantiate a business purpose for any of the expenditures, i.e., they have failed to produce mileage records or establish actual dates, times and business purposes for any of the expenses claimed. Accordingly, it is hereby determined that the Division's disallowance of these car and truck expenses was proper.

E. DEPRECIATION - Petitioners are entitled to no additional allowances for depreciation. Since the family room is not used exclusively for business, petitioners cannot claim depreciation on a rug purchased for use therein. Having failed to establish the business use of their vehicles (*see*, Conclusion of Law "D"), petitioners cannot claim a depreciation expense therefor.

F. INSURANCE - Petitioners are not entitled to claim the expenses for automobile insurance since they have failed to establish the business use of the vehicles. However, as to the \$225.00 payment to AICPA Plus Plan, it is hereby determined that petitioners may properly claim 10% (the amount of their home business use percentage), or \$22.50. This is true despite the fact that the policy also provides coverage for vehicles. Since it also covers the residence

and the policy limits cannot be separated, petitioners are allowed an additional \$22.50 for this insurance expense.

G. BUSINESS INDEBTEDNESS - The business purposes of the credit cards and credit lines were not proven by petitioners. The loan from Sheldon Jacobowitz was, according to the promissory note, in the amount of \$40,000.00, yet petitioner Anwar Riad claims that he borrowed \$55,000.00. The note was supposed to have been paid in full by September 1992 but there was no explanation why payments were still being made in 1996. Despite petitioners' contention that the loan was to cover the additional expense of the home due to the home office, the loan was not made until more than one year after the house was built. Moreover, the office was located within the home; there was no addition required. Clearly, petitioners have failed to establish the business purpose of any of the alleged interest expenses and, as a result, the Division's disallowance of the entire amount claimed was proper.

H. OFFICE EXPENSE - Petitioners have proven no entitlement to claim these expenses. The Division correctly held that the business purpose of these expenditures was not proven.

I. REPAIRS AND MAINTENANCE - As indicated in Finding of Fact "17", petitioners have provided additional invoices which must result in the following additional allowances: invoices totaling \$3,853.00 (\$3,000.00 home repairs, \$153.00 air conditioner service, \$490.00 window repair and \$210.00 electrical service) must be allowed at 10% (the business percentage of home office), or \$385.30. In addition, the invoice for \$199.80 for plumbing services specifically relating to the office bathroom must be allowed in full. Accordingly, petitioners are entitled to an additional repairs and maintenance allowance of \$585.10. The amount allowed for repairs and maintenance is \$790.00 plus \$585.10, for a total of \$1,375.10.

J. SUPPLIES - Subsequent to the first day of hearing, petitioners presented additional receipts which were allowed by the Division. Total allowance was, therefore, increased from \$996.00 to \$1,739.48 (*see*, Finding of Fact “18”). No additional allowances are warranted herein.

K. TAXES AND LICENSES - After initially disallowing all of the \$521.00 claimed, the Division allowed \$421.00 in claimed expenses after petitioners produced receipts therefor (*see*, Finding of Fact “19”). No additional allowances are warranted.

L. MEALS AND ENTERTAINMENT - No documentation was presented by petitioners to substantiate the amount (\$1,405.00) claimed. Accordingly, the Division’s disallowance was proper.

M. UTILITIES - Based upon the proper business percentage for the home office being 10% rather than one-third (33 1/3%) as claimed by petitioners, the Division properly allowed 10% of the electric and heating costs of \$5,284.70, or \$528.47. No additional allowances are warranted.

N. LABOR - Other than the sum of \$500.00 for sums paid to petitioners’ daughters which was allowed by the Division, petitioners have presented no evidence to substantiate the balance (\$1,080.00) claimed for labor expenses.

O. TRAVEL TO CLIENTS - Since petitioners presented no documentation to substantiate the \$9,612.00 claimed as expenses for travel to clients, the Division properly disallowed the entire amount claimed.

P. FEDERAL EXPRESS & POSTAGE - A review of the receipts provided coupled with the credible testimony of petitioner Annette Riad regarding her purchases of postage stamps at Edward’s, a grocery market, reveals that the correct allowance should be \$836.81. Therefore,

the total allowance is increased by \$266.60 for a total allowance of \$836.81 for Federal Express and postage expenses.

Q. CONTINUING EDUCATION - Petitioners provided no documentation which would warrant allowance of any of the \$1,490.00 claimed as expenses for continuing education.

R. PROFESSIONAL DUES - Other than the invoices which were allowed by the Division (*see*, Finding of Fact “33”), no other documentation was provided by petitioners and no further allowances should be made.

S. BOOKS, PERIODICALS, PUBLICATIONS - After reviewing the additional documentation presented by petitioners during the first day of the hearing, the Division revised its allowance of these expenses from an initial \$739.00 to \$1,117.72. While petitioner Anwar Riad claimed expenses for newspapers, such expenses, if incurred, were paid in cash and were, therefore, not substantiated.

T. CHRISTMAS EXPENSES & GRATUITIES - Petitioners failed to establish the business purpose of these claimed expenses and no adjustments are, therefore, warranted.

U. OFFICE CLEANING - As noted in Finding of Fact “29”, the Division allowed one of two exterminator receipts (\$145.00) because it specifically mentioned that services were performed in the office. While petitioners could not prove that the other receipt (\$480.00) was for services for the office, based upon the business percentage of the home office (10%), they must be credited with 10%, or \$48.00 for the extermination services performed in the home. Accordingly, the allowance for office cleaning expenses must be revised to \$193.00.

V. OFFICE PHONES & FAX - No additional allowances are warranted over and above the \$5,939.00 allowed out of the \$6,239.00 claimed.

W. CLIENT EXPENSES - No substantiation was presented and no additional allowances shall be made.

X. BUSINESS GIFTS - Petitioners claimed \$740.00 as expenses incurred for business gifts but supplied no documentation to substantiate these claimed expenses. Accordingly, no allowances therefor shall be made.

Y. BANK CHARGES - The entire amount claimed (\$45.00) was allowed by the Division.

Z. PAINTING - Petitioners have no documentation to support this claimed expense and no allowance is, therefore, warranted.

AA. MAINTENANCE CONTRACTS - The Division properly disallowed the landscaping expenses. Pursuant to IRS Publication 587, unrelated expenses (landscaping is specifically enumerated as an unrelated expense) cannot be deducted. Accordingly, no allowance is warranted.

BB. OTHER MISCELLANEOUS EXPENSES - Petitioners provided no documentation to support the alleged expenses incurred; therefore, no allowance is warranted.

CC. Since petitioners have failed to substantiate the expenses claimed on the additional Schedule C filed for International Trade, it is hereby determined that the Division's disallowance of the entirety of these expenses was proper.

DD. Inasmuch as petitioners have failed to address the issue of penalties and, therefore, have failed to establish reasonable cause for abatement of penalties imposed upon the deficiencies for 1996 and 1997, such penalties are sustained in their entirety.

EE. Pursuant to Conclusions of Law "F" (Insurance), "I" (Repairs and Maintenance), "P" (Federal Express and Postage) and "U" (Office Cleaning), additional allowances are hereby granted to petitioners for Schedule C expenses claimed for 1996. Accordingly, the deficiency



for 1996 must be recalculated. Because the percentage of total expenses allowed to gross receipts reported for 1996 was applied to the gross receipts reported on petitioners' 1997 Schedule C for 1997, by virtue of these additional allowances, the deficiency for 1997 must be recalculated as well.

FF. The petition of Anwar and Annette Riad is granted to the extent indicated in Finding of Fact "44" and Conclusion of Law "EE"; the Division of Taxation is hereby directed to modify the Notice of Deficiency issued to petitioners on June 23, 2000 accordingly; and, except as so granted, the petition is in all other respects denied.

DATED: Troy, New York  
March 27, 2003

/s/ Brian L. Friedman  
ADMINISTRATIVE LAW JUDGE